IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
FORT WORTH DIVISION

IN RE:	§	
	§	Case No. 02-47981-DML
LIFELINE HOME HEALTH	§	Case No. 03-42389-DML
SERVICES, INC.,	§	
	§	(Jointly Administered under Case
LIFELINE MANAGED HOME	§	No. 02-47981-DML)
CARE, INC.,	§	
	§	
Debtors.	§	
	§	

MEMORANDUM OPINION

Before the court is the motion of the named Debtors seeking authority to use cash collateral (the "Motion"). The court considered the Motion at a hearing on August 25, 2003, at which Bank One, N.A. (the "Bank") opposed the Motion. At that time, the court heard the testimony of Michael Poss ("Poss"), president of both Debtors, and Laurel V. Mason ("Mason"), the officer of the Bank responsible for the loans made to Debtors. This matter presents issues subject to this court's core jurisdiction. *See* 28 U.S.C. §§ 1334(a) and 157(b)(2)(A) and (K). This Memorandum Opinion constitutes the court's findings of fact and conclusions of law. FED. R. BANKR. P. 7052 and 9014.

I. Background

Debtors are in the business of providing home health care services. Debtor Lifeline Home Health Services, Inc. ("Lifeline") provides services paid through Medicare and Medicaid. Lifeline Managed Home Care, Inc. ("Management") provides services paid for by private insurance companies. Debtors retain independent contractors -- mostly nurses -- to perform

patient services. Thus, Debtors' assets, except for small amounts of medical inventory and office furnishings and equipment, are largely accounts receivable and cash proceeds of accounts receivable.

Lifeline's case was commenced by the filing of an involuntary petition under chapter 7 of title 11 of the United States Code[1] on October 15, 2002 (the "Lifeline Petition Date"). On November 21, 2002, Lifeline converted the pending involuntary chapter 7 case to a case under chapter 11 of the Code, and on December 11, 2003, Lifeline consented to entry of an order for relief. Management filed a voluntary chapter 11 petition on March 7, 2003.

On the Lifeline Petition Date, Lifeline had accounts receivable totaling $877,222.03. Lifeline had pledged its accounts receivable[2] to the Bank to secure obligations incurred on August 8, 1997 and August 1, 2000, in the amounts of $1,000,000.00 and $425,000.00, respectively.[3] During the period preceding the commencement of Lifeline's case, however, Lifeline also failed to pay the Internal Revenue Service (the "IRS") $689,774.03 in trust fund taxes.[4] Lifeline also owed reimbursement obligations to Medicare and Medicaid totaling $220,506.00 as of the Lifeline Petition Date. Finally, at the commencement of Lifeline's case,

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1 *See* 11 U.S.C. §§ 101-1330, as amended (hereinafter, the "Code").

2 The Bank also asserts liens on the other assets of Lifeline. These assets, however, are not germane to the issues before the court.

3 Both obligations are evidenced by renewed notes dated August 1, 2000.

4 The amount claimed by IRS is $837,020.96, which includes taxes owed plus $147,246.03 in interest and penalties.

Lifeline held $135,904.72 in cash, of which it acknowledges approximately $109,000 to be proceeds of its accounts receivable and, therefore, subject to the Bank's lien.[5]

Concerned about Lifeline's ability to repay its debts, the Bank, on January 30, 2001, obtained a security agreement and financing statement by which Management pledged its accounts receivable. Thereafter, borrowing base certificates submitted to the Bank by Lifeline included Management's accounts receivables. Management, however, executed no note, guaranty, or other paper evidencing liability for Lifeline's obligations to the Bank. Lifeline and Management shared a bank account and personnel. The trust fund tax obligation to the IRS was incurred in furtherance of both Debtors' businesses.

Since the commencement of its case, Lifeline has operated at a loss in each month other than July 2003. At the time of the hearing on the Motion, Lifeline held cash in the amount of $15,846.97 and accounts receivables of $740,279.93.[6] Though Poss testified in support of projections that showed Lifeline would be profitable in the coming months, the court cannot find that Lifeline (or Management) has carried the burden of showing such profits will occur.

The Debtors have been using cash proceeds of accounts receivable pursuant to an Order of this court authorizing use of cash collateral agreed to by the Bank. The initial Order was entered December 12, 2003.[7] The terms of that order were renewed on January 17, 2003;

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5 Pursuant to the cash collateral orders in the case, the Bank has been paid $68,602.50.

6 Accounts receivables are as of June 30, 2003, as reported in Lifeline's most recent Pro Forma Collateral Monitoring Certificate, dated July 23, 2003.

7 The initial order contains the following reference to the position of the IRS: "Nothing in this Order shall prejudice or otherwise affect any right of the United States (Internal Revenue Service) to seek offset or set off pursuant to existing law." Interim Order Authorizing Use of Cash Collateral, para. 17 (*entered* December 12, 2002).

February 3, 2003; February 10, 2003; February 17, 2003; March 19, 2003; and June 16, 2003. A second order was entered July 24, 2003, and a third on July 31, 2003. At the hearing on the Motion, the court continued the terms governing use of cash collateral established by these orders for ten days pending the court's decision on the Motion.

II. Issues

This case presents the following issues that the court must resolve in order to decide the Motion:

1. Was Management obligated to the Bank such that Management's accounts receivable stood as security for the debt of Lifeline to the Bank?
2. Does the Bank have an interest in Lifeline's existing accounts receivable such that the Bank is entitled to adequate protection?
3. Has Lifeline afforded the Bank sufficient adequate protection to permit Debtors to use the Bank's cash collateral?

III. Discussion

A. Management is Not Obligated to the Bank

The Bank argues that it holds a lien on Management's accounts receivable because the Bank has been granted a security interest, Management has rights in the collateral, and value was given. The security agreement executed by Management, however, is limited by its terms to obligations of Management.[8] Yet, the Bank presented no evidence that Management has any

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8 The security agreement provides security for indebtedness. Paragraph 1(d) of the security agreement states, in pertinent part, "The term 'Indebtedness' shall mean (i) all indebtedness, obligations and liabilities of Borrower to Secured Party of any kind or character... (iii) all obligations of Borrower to Secured Party..."

obligation to it. Rather, the Bank argues that (1) the parties *intended* that the security agreement would grant a lien to secure Lifeline's obligations; (2) Lifeline's borrowing-base certificates, by including Management's accounts receivable in calculating loan availability, established this intent; and (3) Lifeline and Management were largely run as one business.

Disposing first of the last of these contentions, the Bank's argument is no more than that the Debtors are alter egos. While it may be that the Bank could establish this to be so, the Bank has not done so. Even if the Bank could, the court is not at this time in the context of the Motion prepared to hold that this would effect the securing of Lifeline's debts with Management's receivables.

In a hearing concerning use of cash collateral under 11 U.S.C. § 363(c)(2), the burden is on the Bank to show that it has a lien on Management's accounts receivables. 11 U.S.C. § 363(o)(2). *See also In re Placid Oil Co.*, 102 B.R. 538, 542 (Bankr. N.D. Tex. 1988) ("The burden of proof on the issues of the validity, priority, or extent of such interest in the cash collateral is on the Banks."); *In re Collins*, 180 B.R. 447, 453 (Bankr. E.D. Va. 1995) ("[U]nder § 363(o)(2), the secured creditor(s) bears the burden of proof to establish the extent of its interest."). The Bank has not satisfied that burden by showing by a preponderance of the evidence the identity of indebtedness of Management with Lifeline.

Likewise, the Bank has not proven by a preponderance of the evidence that it has a claim created by Management that is secured by Management's accounts receivable. For present purposes, the court need not determine whether such a claim may exist in an ordinary lender-debtor relationship absent a specific instrument creating it. While such a proposition seems

doubtful, it need not be rejected out of hand. Rather, given the limitations on the obligation described in the security agreement, the court cannot find that the existence of such an obligation, by virtue of Lifeline's borrowings, has been shown to exist by a preponderance of the evidence.

B. The Bank's Interest in Lifeline's Accounts Receivables

1. The IRS's Secured Claim

This case presents interesting questions of law arising from the position of the IRS with respect to Lifeline's Medicare accounts receivable and the Bank's lien. It is clear that the IRS has a right of offset with respect of prepetition receivables owed to Lifeline by Medicare. *See In re Alliance Health of Fort Worth, Inc.*, 240 B.R. 699, 704 (Bankr. N.D. Tex. 1999) ("There is no question that the government has the right to apply monies due it to the extinguishment of its obligations on other accounts."); *In re Nuclear Imaging Systems, Inc.*, 260 B.R. 724, 733 (Bankr. E.D. Pa. 2000) ("In general, the United States has the same common law right to setoff as any other creditor. Moreover, 'outside of bankruptcy, the federal government is considered a single-entity that is entitled to set off one agency's debt to a party against that party's debt to another agency.'"). This means the IRS had, as of the Lifeline Petition Date, a claim secured by those receivables. 11 U.S.C. §§ 502(b) and 506(a). *See also In re Nuclear Imaging Systems, Inc.*, 260 B.R. at 729 ("By virtue of section 506(a), a setoff gives rise to an allowed secure claim."). The IRS's secured claim was senior to that of the Bank.[9]

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9 *See In re* Alliance Health of Fort Worth, Inc., 240 B.R. at 704 (holding that former section 9.318 (section 9.404, as amended by Acts 1999, 76th Leg., ch. 414, § 1.01, eff. July 1, 2001) of the Uniform Commercial Code determines that the right to set off (a defense to payment) prevails over a perfected security interest

It is less clear whether the IRS's secured claim attached to Medicaid receivables. Though largely funded by the federal government, the Medicaid program is administered by the states. *See Curtis v. Taylor*, 625 F.2d 645, 649 (5th Cir. 1980); *Children's Healthcare Is A Legal Duty, Inc. v. De Parle*, 212 F.3d 1084, 1088 (8th Cir. 2000). In any case, Debtors presented evidence that suggested Medicaid receivables exceeded Medicaid reimbursement obligations as of the Lifeline Petition Date. The court, however, has not enough evidence nor have the parties briefed the set off issue. Thus it is unable to assess fully the legal or factual status then or at present of Medicaid receivables and concludes the Bank may have rights arising from the collection of Medicaid receivables.

Also, the IRS may have had a secured claim against Lifeline's receivables, but the IRS has neither a lien nor did it receive a security agreement. At the hearing on the Motion, the court raised the question of whether 11 U.S.C. § 724(b) gave the Bank rights that, in a liquidation, would be superior to those of the IRS. Section 724(b) effectively subordinates a tax lien to priority claims, including those arising by reason of failure of adequate protection.[10] The statute, however, refers only to *liens*, and the IRS, though the holder of a secured claim, does not have a lien. *See Folger Adam Sec., Inc. v. DeMatteis/MacGregor, JV*, 209 F.3d 252, 260 (3d Cir. 2000)

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unless the account debtor had actual notice of the security interest before the set off right accrued and that mere filing of a UCC financing statement is not notice for purposes of that section).

10 *See* 11 U.S.C. §724(b) ("Property in which the estate has an interest and that is subject to a lien that is not avoidable [the Code] and that secures an allowed claim for a tax, or proceeds of such property, shall be distributed-- ... (2) second, to any holder of a claim of a kind specified in section 507(a)(1), 507(a)(2), 507(a)(3), 507(a)(4), 507(a)(5), 507(a)(6), or 507(a)(7) of this title, to the extent of the amount of such allowed tax claim that is secured by such tax lien; (3) third, to the holder of such tax lien, to any extent that such holder's allowed tax claim that is secured by such tax lien exceeds any amount distributed under paragraph (2) of this subsection;...").

("It is clear from the definitions of 'lien' and 'setoff' that the term 'setoff' does not refer to the same type of interest as a 'lien.'"). The court must accord the Bankruptcy Code its plain meaning.[11] In section 724, Congress chose the word "lien," not "secured claim." Other courts considering whether section 724(b) applied to governmental offset rights have concluded from this language that it did not. *See United States v. Morgan (In re Morgan)*, 196 B.R. 758, 761-62 (E.D. Ky. 1996). This court shares that view and concludes that, for purposes of determining what interest the Bank has in cash collateral, section 724 has no application.

The same plain meaning rule dictates that, upon conversion into cash proceeds, the Medicare receivables would, under 11 U.S.C. § 552(a),[12] cease to be subject to the secured claim of the IRS. This is so because section 552 only allows a security interest to attach to proceeds if it is evidenced by a security agreement.[13] Thus, unless the language of the initial cash collateral order quoted above varied application of section 552, collection of accounts receivable and the subsequent creation of new accounts would have effected a cleansing of Lifeline's receivables of

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11 *See e.g.* Union Bank v. Wolas, 502 U.S. 151, 161-62, 112 S.Ct. 527, 533 (1991) (holding that the fact that Congress may not have foreseen all of the consequences of a statutory enactment is not a sufficient reason for refusing to give effect to the statute's plain meaning); United States v. Ron Pair Enterprises, Inc., 489 U.S. 235, 241, 109 S.Ct. 1026, 1030 (1989) (holding that the task of resolving dispute over meaning of section 506(b) began where all such inquires must begin: with the language of the statute itself).

12 *See* 11 U.S.C. §552(a) ("Except as provided in subsection (b) of this section, property acquired by the estate or by the debtor after the commencement of the case is not subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case.")

13 *See* 11 U.S.C. §552(b)(1) ("Except as provided in sections 363, 506(c), 522, 544, 545, 547, and 548 of this title, if the debtor and an entity entered into a security agreement before the commencement of the case and if the security interest created by such security agreement extends to property of the debtor acquired before the commencement of the case and to proceeds, product, offspring, or profits of such property, then such security interest extends to such proceeds, product, offspring, or profits acquired by the estate after the commencement of the case to the extent provided by such security agreement and by applicable nonbankruptcy law, except to any extent that the court, after notice and a hearing and based on the equities of the case, orders otherwise.")

the IRS's right to set off. Though, as discussed below, this does not matter in determining what interest the Bank has that is entitled to protection, it does matter in determining what protection the Debtors can now provide the Bank.

2. The Extent of the Bank's Secured Claim

The Bank's secured claim against Lifeline must be determined as of the Lifeline Petition Date. With regard to cash and accounts receivable, the only assets relevant for purposes of consideration of the Motion, the court must determine, first, whether the absence of an IRS interest in proceeds would give the Bank an enhanced position respecting receivables.

The court concludes that it does not. 11 U.S.C. § 502(b) specifically requires that the court determine a claim *as of the date of filing of the petition*. On the Lifeline Petition Date, the amount owed to the IRS exceeded the amount owed to Lifeline by Medicare. Thus, the receivables subject to IRS offset could not be property of Lifeline's estate in which the Bank could have an interest. Since, at the moment of filing, the Bank could have no interest in those receivables, it could not have an interest in the proceeds of those receivables.

The cash held by Lifeline at the time of filing and the Medicaid receivables are a different matter. As to the former, there is presently no dispute that $109,000 of the cash was the Bank's cash collateral. As to the latter, the court lacks sufficient information to determine what interest the Bank had in the Medicaid accounts receivable. The court will, however, consider in its decision the possibility that the Bank has an interest entitled to protection that arises from Medicaid accounts receivable.

Since the cash subject to the Bank's lien held at commencement of the case totaled $109,000 and Bank has been paid $68,602.50 pursuant to the cash collateral orders, the Bank's

secured claim is no less than $40,397.50. If the Bank's secured claim covers Medicaid receivables, its maximum amount would be $222,208.08 ($40,297.50 plus $181,910.58, the Medicaid accounts receivable as of the Lifeline Petition Date).

C. Protection of the Bank

Turning to protection of the Bank's interest, the position of the IRS now becomes critical. If the existing Medicare accounts receivable have been "cleansed" of the IRS's right to offset, or if the grant to the Bank of a post petition lien on receivables comes ahead of the IRS right of offset, the Bank is adequately protected notwithstanding the deterioration in the amount of receivables, since Lifeline's total receivables as of June 30, 2003 were $740,279.93,[14] while the Bank's interest is no greater than $222,308.08.[15] What interest the IRS has in the existing receivables is dependent upon (1) what portion, if any, of the receivables are prepetition;[16] and (2) the effect of the language in the initial cash collateral order quoted above. Although it apparently received notice of the hearing, the IRS did not participate in the hearing on the Motion.

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14 From Lifeline's most recent pro forma collateral Monitoring Certificate, dated July 23, 2003.

15 The court's task is complicated by several factors. First, the court has no firm evidence of how receivables have turned over since the commencement of Lifeline's case and so does not know with certainty the proportion of receivables generated post-petition and cleansed of the IRS's secured claim. Second, Debtors maintain that the receivables will substantially decrease in value in a liquidation context.

16 Lack of mutuality would prevent set off of a prepetition IRS liability against a post-petition debt of Medicare to Lifeline. 11 U.S.C. § 553(a), which preserves the right of set off, provides:

> (a) Except as otherwise provided in this section and in sections 362 and 363 of this title, this title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case, except to the extent that --

The court is not willing at this time to dispose of questions about the IRS's secured claim. As noted above, there are several issues of fact that have not been sufficiently explored for the court to be comfortable that either the Bank or Debtors has met its burden of proof under Section 363(o) necessary to prevail. The court, thus, will not grant or deny the Motion at this time. The court will provide limited relief on the Motion until it can complete review of these issues.

IV. Conclusion

The United States Trustee has filed a motion to dismiss or convert this case. Originally set for September 23, 2003, that motion has been reset to September 16, 2003. Debtors have filed a motion to value the Bank's secured claim. That will necessarily require determination of the IRS's secured claim.

The latter motion will likewise be set for September 16, 2003, at which time the court will also determine, on its own motion, the IRS's secured claim. FED. R. BANKR. P. 3012. The Motion, except as specified herein, will be continued to that time.

Pending the hearing discussed above, Debtors may use proceeds of their accounts receivable as proposed in the Motion, with protections to continue as under prior orders authorizing use of cash collateral.

It is so ORDERED.

Signed this the 8th day of September 2003.

DENNIS MICHAEL LYNN,
UNITED STATES BANKRUPTCY JUDGE